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## N. Springs office market grows

The United States' and Colorado's economic growth continued at a strong pace through 2006 and the impact on north Colorado Springs can be seen throughout the real estate market. Specifically in the office market, strong economic growth has translated into job growth, which in turn means more demand for office space. This growth has gone hand in hand with the explosive residential growth in the northern Colorado Springs area, one of the most robust housing markets in the state. As a result of this activity, the three main office parks in this market – Briargate Business Campus, owned by La Plata Investments, Interquest, owned by a venture between Norwood Development and Corporate Office Properties Trust, and Northgate, owned by Gary Ericson – all saw declining vacancy rates and increasing rental rates in 2006.

According to Turner Commercial Research of Colorado Springs, metro Colorado Springs office vacancy rates declined to 6.9 percent by the end of 2006, their lowest level since the same period of 2000. In addition to the declining vacancy rates, rental rates increased across the metro area by an average of 3.5 percent in 2006. At the end of 2006 northeast Colorado Springs, as defined by Turner Commercial, had an average vacancy rate of 5.9 percent.

Along with this improving office market condition comes new office buildings on both the owner-user side and on the speculative side. On the owner-user side, T. Rowe Price is under construction with Building 2, a 147,000-square-foot office building being developed by Prime West Development Inc. This building is the next phase of its 32-acre office campus in Briargate Business Campus. Additionally, FedEx is expanding its presence by building a 113,000-sf data center in Northgate, which is under construction. Progressive Insurance also has become a major employer in the Northgate Business Park.

On the speculative side, office condominiums are the only material source of speculative development in north Colorado Springs. There are currently 126,000 sf of office condominiums under construction in Briargate Business Campus between the Promontory at Briargate, located at Chapel Hills Drive and Research Boulevard being developed by Prime West and ORIX, and The Courtyards project on Highway 83 being developed by RDB Solomon. Powers Office Park, located in Briargate Crossing at Briargate



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Parkway and Powers Boulevard, is a 340,000-sf medical office condominium project being developed in two phases by Powers Commercial Group. North of Briargate, a number of smaller projects have been completed in Northgate and Interquest. These successful office condominium projects were built over several phases and have all sold out.

While there are office condominiums currently under construction, there are only smaller for-lease buildings being built with a few larger projects still on the drawing boards at 9955 Federal, 9956 Federal and 6071 Woodmen Road. High construction costs are making for-lease projects cost prohibitive because the lease rates needed to justify new construction are not currently attainable in the market. There is currently 210,000 sf of proposed speculative office space in north Colorado Springs being marketed between \$18 and \$19 per rentable sf, triple net. With the current average market rent closer to \$14 per sf, triple net, developers can't justify new speculative for-lease office projects. This bodes very well for the owners of existing office buildings whose cost basis is well below that of a similar new building. Rental rates in existing office buildings can be increased substantially before they approach the rental rates needed for a new building. This makes existing buildings the biggest beneficiary of the increase in construction cost and the concurrent increase in demand for office space. Tenants should expect to experience substantial rental rate increases over the next several years when their leases roll over. This fact, combined with the abundance of capital chasing investment-grade real estate, account for the high price per sf being paid by investors for existing buildings.

At the same time, low mortgage rates have made office condominiums more affordable to small-business owners. For example, an individual or company can purchase an office condominium with a 10 percent down payment, borrowing the balance at approximately 7 percent interest with a 25-year amortization. After debt service, operating expenses, deductions for interest payments and depreciation, the owner will pay the

same yearly occupancy cost on a per square foot basis as a tenant leasing space in an existing building, paying approximately \$14 per sf, triple net. However, that individual or company's net cost of ownership in a new office condominium will be approximately \$4 to \$5 per sf cheaper than new proposed office space for lease. This does not take into account the buildup of equity or any appreciation the owner may experience. This phenomenon should make office condos an attractive alternative to certain tenants currently leasing.

Two additional office space demand generators are currently being built in Northern Colorado Springs: Penrose Hospital North and Memorial Hospital North. Both new hospital campuses have encouraged medical office building projects in their immediate areas. Prime West Development Inc. is developing the 170,000-sf Medical Pavilion at Briargate for Healthcare Realty Trust at the main entrance to the 82-acre Memorial Hospital North campus. The for-lease project consists of two 85,000-sf, three-story buildings and will break ground this month. Closer to Penrose Hospital a new medical office condominium project has been announced. The 340,000-sf Powers Office Park, to be developed by Powers Commercial Group, will serve doctors who practice at either hospital. This project will be built over two phases. Phase I will include more than 180,000 sf of medical office condominium space and is scheduled to break ground by the end of May. Groundbreaking for Phase II is not yet scheduled. Powers Office Park will have some amenities not found in other medical office condo projects such as limited underground parking. Being priced at \$200 to \$240 per sf, they will be the most expensive office condominium project in the market to date.

The north Colorado Springs office market does not compare in size to the office markets found in the Denver metro area. However, it is one of the more dynamic office markets in Colorado. Office condominiums are the only speculative space currently under construction, but for-lease product will follow once vacancy rates decrease to the point where rental rates can be increased to the level required to justify new construction of for-lease product. In the interim, tenants should expect substantial rental rate increases over the next several years as vacancy decreases and no new product is developed.▲